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IN THE

Supreme Court of the United States

October Term, 1963

No. 862

BERNARD REICH and SYLVIA REICH, depositors and members of BEVERLY HILLS FEDERAL SAVINGS AND LOAN ASSOCIATION, individually and in behalf of BEVERLY HILLS FEDERAL SAVINGS AND LOAN ASSOCIATION and the other depositor-members of said association, similarly situated,

Petitioners,

vs.

EUGENE WEBB, JR., MARGUERITE R. WEBB and BEVERLY HILLS FEDERAL SAVINGS AND LOAN ASSOCIATION,

Respondents.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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I.

Respondents' Contention That the Decision Below Rests on an Adequate and Independent State Ground and Is Not Within 28 USC 1257(3) Is Without Merit.

The two integral parts of the decision below are (a) that as a matter of federal law there is an available administrative remedy before the Federal Home Loan Bank Board with respect to petitioner's claim, and (b) that under state or federal law, petitioners are obligated to exhaust this remedy prior to judicial action. With respect to these two aspects of the decision, it is cer-

tainly apparent as a matter of common sense and logic that the critical decision is the *existence under federal law of a remedy* since without that determination the general principle of exhaustion *decides no issue.* That this federal question was the critical decision below is shown by the language of the opinion and by the language of the earlier decisions upon which the opinion relies. Thus the court below said,

> "Since the rules and regulations of the Home Loan Bank Board contain detailed provisions regarding the government of such internal affairs the plaintiffs are thereby afforded administrative remedies. It does not appear from the amended complaint that plaintiffs have exhausted such remedies. There is nothing in the record to indicate that they could have amended to include such an allegation. The court did not err in sustaining the demurrers without leave to amend." (Pet. (Appx. B. p. 13.)

In *Larwood Co. v. San Diego Federal Savings & Loan Association*, 185 Cal. App. 2d 450, 8 Cal. Rptr. 362, the court expressly labeled the *federal* question as the critical question. Thus, the court said in deciding that there was no duty to exhaust:

> "From the foregoing, it will be seen that the decision of the present cause *must* lie in whether or not, by any fair construction of the laws of Congress and the rules of board, it is intended that board determine private controversies between borrowers and the association." (Emphasis supplied).

In *Woodward v. Broadway Federal Savings and Loan Assn.*, 111 Cal. App. 2d 218, 244 P. 2d 467, the

principal decision relied upon by the court below, the court, after discussing in detail the provisions of the act and the regulations, stated as respects that action:

> "Since an administrative remedy is provided, the plaintiffs must first exhaust that remedy before turning to the courts for relief."

As this court stated in *Ivanhoe Irrigation District v. McCracken* (1958), 357 U. S. 275, 2 L. Ed. 1313, 70 S. Ct. 774, when it rejected appeal but granted certiorari to review a decision of the California courts wherein federal and state issue questions were similarly interwoven:

> "Basically, it is the interpretation of the federal act that opens the door to the application of the state law . . . (citations)."

This court's decision in *Enterprise Irrigation District v. Farmers Mutual Canal Co.*, 243 U. S. 164, is also relevant wherein it was held that:

> "Where the non-federal ground is so interwoven with the other as not to be an independent matter . . . our jurisdiction is plain."

Similarly here, it is the interpretation of the federal statute, *i.e.*, the Federal Home Loan Act of 1933, and the regulations of the Board, as to the existence or non-existence of a federal administrative remedy applicable and available as respects petitioners' claim which opens or closes the door to the application of the "exhaustion" rule of law.

Of course, it follows logically that, insofar as the decision below included reference to a *general rule* requiring exhaustion of administrative remedies, the decision of that question standing alone was neither "*adequate*"

nor "independent," within the meaning of this court's certiorari decisions, to support the judgment. The federal question was critical.

Enterprise Irrigation District v. Farmers Mutual Canal Co., 243 U. S. 157, 164;
Murdock v. Memphis, 20 Wall. 590, 630;
Eustic v. Bolles, 150 U. S. 361, 370.

Respondents, who assert that there is *no* federal question raised below, also assert that there is no jurisdiction in this Court. It is difficult to understand the contention that when respondents claimed the *right* or *privilege* under *federal law* of requiring exhaustion of an allegedly available *federal remedy* or when respondents asserted that petitioner's action should be dismissed and that respondents were *immune from judgment in this action* by the California court, subject to a proceeding under a *federal statute*, that this does not constitute a federal question within the meaning of 28 U.S.C. 1257(3).

It should be recalled that petitioner's action below was dismissed as a result of respondent's defense. Such dismissal, the California court decided, was required, "since the rules and regulations of the Home Loan Bank Board contained detailed provisions regarding the government of such internal affairs" and the plaintiffs are therefore afforded administrative remedies. (App. B, p. 3). This dismissal certainly results in an "immunity" for respondents in this action but more important, *this immunity may well be permanent.* There is a stat-

ute of limitations in California with respect to the recovery for breach of fiduciary duty which may be either three years or four years (Calif. Code Civ. Proc., §§343, 338(4)). There can be no contention that the act or the regulations permit the Board to recover moneys from former directors for breach of fiduciary duty. Thus, if the Board has no standing to sue former directors for money relief—and for thirty years this has been the uniform interpretation of the statute—then during the course of petitioners' required but hopeless application to the Board for administrative relief and the potential *de novo* hearings and appeals, the Statute of Limitations may well run.[1]

In this case the sum of $1,500,000 was taken by the respondents Webb in 1961. It is not too drastic a statement to make that unless certiorari is granted in this case and the action reinstated that the members of the association are exposed to an overwhelming risk that the rights of the members of this federal association to recover for the breaches of fiduciary duty alleged will never be adjudicated and the relief for the association based upon these rights will never be obtained.

With respect to jurisdiction of this court under 28 U.S.C. 1257(3), it has long been established that assertion under federal law that the jurisdiction of a fed-

[1]It should be noted again that the act provides unusual provisions for *de novo* proceedings in federal court at the instance of either the board or the association as a substitute for a hearing commenced by the board. There is also review by the court of appeals under the Administrative Procedure Act (12 U. S. C. A. §1464(d)(1)).

eral agency or court *delays, diverts* or *precludes* a state court action is the assertion of a "right, privilege or immunity" under a federal statute so as to give this court jurisdiction.[2]

Williams v. First National Bank, 216 U. S. 582, 54 L. Ed. 625, and cases cited beginning at p. 626;

Texas and Pacific Railway v. Abilene Cotton Oil Co., 204 U. S. 426, 51 L. Ed. 553;

Loomis v. Lehigh Valley Railway Co., 240 U. S. 43, 60 L. Ed. 517;

Great Northern Railway Co. v. Merchants Elevator Co., 259 U. S. 285, 66 L. Ed. 943.

Thus, it is clear that a critical and highly important determination of a federal question upon federal grounds was rendered by the court below to which this court's jurisdiction clearly applies.[3]

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[2]Since the California court here held *it had no* jurisdiction, respondents Webb assert, upon the authority of Professor Davis, that such determinations are really "primary jurisdiction" decisions. (See Brief of Respondents Webb, page 7.) It should be noted that as respects the jurisdiction of this court, the assertion of a right, privilege or immunity is no less a *federal* question whether the judgment below rests upon "primary jurisdiction" of a federal agency or court or "exhaustion of administrative remedies" of a federal agency.

[3]Respondent Beverly Hills Federal asserts that unless "compulsion" of federal law or discrimination is shown, jurisdiction is not established. Assuming the correctness of this rule, it was the alleged compulsion of federal law as to the existence of an administrative remedy which resulted in the dismissal below. Moreover, no showing has been made that shareholders in other California corporations must complete an irrelevant exhaustion of remedies prior to judicial action.

II.

The Two Provisions of the Board's Rules Which Respondents Assert Provide an Administrative Remedy in This Action Are Irrelevant to Respondents' Contentions and in Fact Disprove Their Argument.

Respondents Webb, at pages 8 and 9 of their Brief, cite only the following two provisions of the board's rules and regulations as being relevant to the question of the availability of an administrative remedy insofar as petitioners' second cause of action is concerned.

(a) Section 544.5, subdivisions 6 and 7 of Part 544.

(b) Section 542.2 of Part 542 of the Board's Rules.

The first of these sections refers to two provisions of the form of By-laws contained in Charter K, the form of charter prescribed by the board and adopted by respondent Association. The two provisions of the By-laws, subdivisions 6 and 7, read as follows:

> "6. *Resignation of directors.* Any director may resign at any time by sending a written notice of such resignation to the office of the association delivered to the secretary. Unless otherwise specified therein, such resignation shall take effect upon receipt thereof by the secretary. More than three consecutive absences from regular meetings of the board of directors, unless excused by resolution of the board of directors, shall automatically constitute a resignation, effective when such resignation is accepted by the board of directors.
>
> "7. *Powers of the Board.* The board of directors shall have power—
>
> (a) To appoint and remove by resolution the members of an executive committee, the members

of which shall be directors, which committee shall have and exercise the powers of the board of directors between the meetings of the board of directors;

(b) To appoint and remove by resolution the members of such other committees as may be deemed necessary and prescribe the duties thereof;

(c) To fix the compensation of directors, officers, and employees; and to remove any officer or employee at any time with or without cause;

(d) To extend leniency and indulgence to borrowing members who are in distress and generally to compromise and settle any debts and claims;

(e) To limit payments on capital which may be accepted;

(f) To reject any application for savings accounts or membership; and

(g) To exercise any and all of the powers of the association not expressly reserved by the charter to the members."

It should be noted that By-law subdivision 6 above refers only to *resignation* of directors and is utterly immaterial to the charge that the directors profited privately from selling proxies and directorships. Subdivision 7 above refers to the *powers* of the board and again says nothing whatsoever as to the fiduciary obligation of directors not to sell proxies and directorships and to keep the moneys for themselves. The claim in petitioner's second cause of action is a claim which falls within an ancient tradition. It was stated in *Securities and Exchange Commission v. Insurance Securities* (C.A. 9, 1958), 254 F. 2d 642, 649 as follows:

"It is a general principle of equity that a personal trustee cannot sell his office nor may this be done by a corporate officer or director . . . a member of a class who assumes to exercise or enforce a class right may not sell it for his own profit . . . directors of a solvent corporation may not take over for their own profit an opportunity available to the corporation . . . the president, director and dominant stockholder of a corporation may not sell a controlling stock interest in the corporation to outsiders where the result would be to deprive the corporation of opportunities for gain for controlling distribution to such outsiders. *Perlman v. Feldmann* (C.A.2d 1955) 219 Fed. (2d) 173.

"The cited cases exemplify two well established principles of equity. One of these is that a person, trustee, corporate officer or director or other person standing in a fiduciary relationship with another may not sell or transfer such office for personal gain.

"The second principle of equity exemplified in cited cases is that a person occupying a fiduciary relationship with another will not be permitted to exploit such relationship for personal gain, and in such a manner as to deprive the other of assets to which he is entitled."

It defies logic to find in subdivisions 6 and 7 above any language which regulates the fiduciary duties of directors and officers of a federal savings and loan association to the association or its members.

The second section of the rules cited by petitioner reads as follows:

"§542.2 *Hearings. Any person who has made an application or petition to the Board pursuant to any provision of Parts 543, 544, 545, or 546 of this subchapter may request a hearing thereon provided such application or petition has been denied or disapproved by the Board.* At any time after the filing of any such application or petition and before consideration thereof by the Board, any interested person may request a hearing upon such application or petition. *The Board may order a hearing in connection with the consideration of any matter arising under any provision of the rules and regulations in this subchapter, whether or not any* request *therefor has been made by any person.* The Board may deny any request for, or dispense with, any hearing for which this section provides when, in its judgment, no need therefor exists." (12 C. F. R. Chapter V, Subchapter C, Section 542.2)

We stated in the petition and repeat here that neither the first or third sentences of Section 542.2 have *any reference to the claims in petitioner's Second Cause of Action.* The first sentence relates to applications or petitions pursuant to any provisions of Sections 543, 544, 545 or 546 of the Board's Rules. As we have noted above, there is nothing in any of these parts which relates to the breach of fiduciary duty, asserting the liability of former directors of an association for that breach, or which touches the consideration of any of the issues related thereto. Respondents have not controverted this contention. Similarly, this claim is not a "matter arising under any provision of the rules or reg-

ulations in this sub-chapter" because the Board has not adopted any rules or regulations covering the substantive liability of the parties or the relief which is involved in this claim.[4]

We noted the following facts in the petition as respects the act and the board's regulations thereunder:

1. There is no provision for the board to bring any action against former directors of an association to recover moneys for breach of fiduciary duty.

2. Sec. 1464(d)(1) does not contain any provision for the board to bring any action against former directors for any relief whatsoever.

3. The power of the Board as to the matter of breach of fiduciary duty is confined by 1464(d)(1) to the power "to enforce this section and rules and regulations made hereunder." The board has not adopted any rules or regulations to apply to the fiduciary duties of directors and it certainly has not purported to regulate the sale by directors of proxies or directorships.

4. The board cannot enforce regulations which it has not adopted or published. The Administrative Procedure Act forbids it.

5. In 30 years of administering the act, there was not a single case of assertion by the board of liability against anyone other than the association.

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[4]As noted in the petition, the court below declined to make an analysis of the provisions of the Board's Rules but relied entirely upon the proposition that the Board had "broad and comprehensive powers". But the Board has not exercised its powers as respects petitioner's claim and, in fact, is not *given* the power to sue former directors or to recover from them money relief arising from their breach of their fiduciary obligations.

6. Every statutory provision for hearing, including service, notice, venue and costs, designates the parties as the board and the association.

Respondents have not refuted or disputed any one of the foregoing propositions. The conclusion that there is no actual or arguable jurisdiction at least as respects petitioner's second cause of action is therefore indisputable.[5]

III.

The Pendency of the Declaratory Relief Action in the Federal Court in the Southern District of California and the Pendency of Petitioner's Action in That Court Do Not Render the Pending Petition Moot.

It is clear from the brief filed by respondents Webb that they continue to retain in excess of $1,500,000.00 received by them in connection with their sale of directorships and proxies for Beverly Hills Federal Savings and Loan Association. These respondents do not assert that they have paid over these funds to the Association. It is clear, therefore, that these claims made by petitioners in their complaint are not and cannot be moot.

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[5]At pages 18 through 21 of the petition, petitioners cited five decisions of this Court which establish criteria for rejecting or requiring an alleged administrative proceeding as a condition of judicial action. Those cases hold (1) that if the asserted remedy is based on an inapplicable regulation, or (2) would result in a determination which would be void as to the parties involved, or (3) requires a hearing which will not bind the real parties in interest, or (4) is based upon a remedy which is uncertain, that exhaustion of such remedies is not required. As we have noted above: (1) There are no applicable regulations at least to petitioners' Second Cause of Action; (2) any determination by the Board as to recovery of moneys against former directors would be patently void; (3) petitioner and the former directors who are the real parties in interest in the action would not be bound by any determination of the Board; (4) to say the least, the remedy is uncertain. Respondents have not met any of these contentions.

It is also clear from respondent's brief that petitioners have not been permitted to proceed with their action to assert the right to recover from the Webb respondents for their breach of fiduciary duty. Thus, as to this issue, the dispute is not and cannot be moot.

It is true that petitioners have by every lawful means possible sought to protect the right of the members of the Association to recover from the former directors of the Association the moneys which rightfully belonged to the assured. Petitioners assert, and with all due deference submit, it is *undeniable* that Section 1464 (d)(1) does not give the Board the power to sue former directors for money for breach of fiduciary duty. Petitioners' attempt in the action cited above to make that point and to intervene for the purpose of having in the action parties who could recover has been, to this point, denied. If petitioners are correct as to the lack of jurisdiction in the Board, then the federal proceeding cannot bring the relief to which the members of the Association are entitled. It is only in *this action*, and only if this Court grants certiorari, that this relief can be assured. Thus, far from "mootness," the facts which petitioners brought to the attention of the courts below and to this court as to the other proceedings, emphasize the urgency of the determination of the questions presented in this petition.

Conclusion.

The question in this case involves the rights of hundreds of thousands of depositors of Federal Savings and Loan Associations to preserve their equity in an Association by judicial relief without the necessity of Washington litigation. The enforcement of fiduciary duties

of directors is an every-day, garden-variety function of state courts. Agency expertise is completely irrelevant; delays in the protection of these rights is absolutely unconsciable. The imposition of costs for Washington litigation is completely unjustified. The asserted requirement for statutory exhaustion finds no support in the statute.

Respondents cannot deny and do not deny that the question is important and that only this Court can decide it.

The petition for certiorari should be granted.

Respectfully submitted.

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